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**STATE OF WASHINGTON
DEPARTMENT OF FINANCIAL INSTITUTIONS
SECURITIES DIVISION**

IN THE MATTER OF DETERMINING
Whether there has been a violation
of the Securities Act of Washington by:

Preferred Funding, Inc.,
Respondent

SDO 54 - 01

STATEMENT OF CHARGES AND NOTICE OF
INTENTION TO SUSPEND AND FINE
PREFERRED FUNDING, INC.

Case No. 01-05-202

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THE STATE OF WASHINGTON TO: Preferred Funding, Inc.
733 Seventh Ave., Suite 110
Kirkland, WA 98033

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STATEMENT OF CHARGES

Please take notice that the Securities Administrator of the State of Washington has reason to believe that Respondent Preferred Funding, Inc. has willfully failed to comply with provisions of the Securities Act of Washington, while operating a registered broker-dealer selling interests in mortgage paper securities, and that those practices justify a six (6) month suspension and \$30,000 fine of Respondent pursuant to RCW 21.20.110. The Securities Administrator finds as follows:

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TENTATIVE FINDINGS OF FACT

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RESPONDENT

1. Preferred Funding, Inc (Preferred) is a Washington Corporation with its principal place of business at 733 Seventh Ave., Suite 110, Kirkland, WA 98033.
2. Preferred is engaged in the business of offering and selling "mortgage paper securities" pursuant to the provisions of WAC 460-33A.

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STATEMENT OF CHARGES AND
NOTICE OF INTENTION TO SUSPEND
AND FINE PREFERRED FUNDING, INC.

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DEPARTMENT OF FINANCIAL INSTITUTIONS
Securities Division
PO Box 9033
Olympia, WA 98507-9033
360-902-8760

1 3. Preferred is a mortgage broker-dealer, as defined in WAC 460-33A-015, and is licensed with the
2 Securities Division, pursuant to RCW 21.20.040, to effect transactions in mortgage paper securities registered
3 under the provisions of WAC 460-33A.

4 **2001 EXAM**

5 4. The Securities Division field examination team (“Staff”) conducted an on site examination, of
6 Preferred, from April 30, 2001 through May 2, 2001 (“2001 Exam”). On June 8, 2001 the Staff sent Preferred a
7 Letter of Caution regarding the deficiencies found during the 2001 Exam and requested a written response, within
8 30 days, describing the steps that Preferred intended to take to correct the deficiencies.¹ To date the Staff has not
9 received the requested response from Preferred.

10 **NATURE OF PREFERRED’S CONDUCT**

11 Preferred disbursed funds prior to recording investor’s security interests

12 5. During the 2001 Exam the Staff found that Preferred distributed funds to borrowers before investors’
13 security interests were recorded. In some instances the delay in the recordation of investors’ security interests was
14 over four weeks in duration. For example, in the Kenneth E. Causey Sr. Loan, No. 2000-1051, involving six
15 investors, the funds were distributed from “escrow” on June 16, 2000, while the Assignments of Deed of Trust were
16 not recorded until July 25, 2000. The Staff also found that in the Fred Willet Loan, No. 2000-0152, the funds
17 provided by three investors were distributed from “escrow” on June 16, 2000, while the Assignments of Deed of Trust
18 were not recorded until July 25, 2000, leaving the investors unsecured for over four weeks.

19 Preferred failed to retain investor suitability questionnaires

20 6. During the 2001 Exam the Staff found that Preferred failed to maintain investor suitability questionnaires
21 in all loan files. For example, the file for Loan No. 2000-0174 did not contain a copy of the suitability questionnaire
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23 ¹ See attached letter from Kristina Kneip, Department of Financial Institutions, Securities Division, to Michael S. Kaminski,
24 Preferred Funding, Inc. (June 8, 2001).

1 for investor Hoffman. In addition, the file for Loan No. 1999-0104 did not contain copies of the suitability
2 questionnaires for three investors, Reos, Remple and Levek Family, L.P.

3 Preferred made construction loans without prior approval of the administrator

4 7. During the 2001 Exam the Staff found that Preferred offered and sold mortgage paper securities,
5 specifically construction loans as defined under WAC 460-33A-015(7), to at least 48 investors, during the period of
6 1999 through May 2001. Preferred has not received written approval of the administrator to offer and sell
7 construction loans.

8 Preferred offered and sold construction loans with excessive loan to value ratios

9 8. During the 2001 Exam the Staff found that Preferred offered and sold interests in several construction
10 loans having loan to value ratios greater than fifty percent (50%). For example, Loan No. 2000-0148 for \$2,200,000
11 was secured by property that was appraised on an "as is" basis at \$620,000 and appraised on an "as built" basis at
12 \$2,000,000, resulting in loan to value ratios of 355% and 110% respectively. Similarly, in Loan No. 2000-0161 for
13 \$1,100,000 secured by property appraised on an "as is" basis at \$1,530,000, the resulting loan to value ratio was 52%.
14 In addition, in Loan No. 2000-1076 for \$265,000 was secured by property appraised on an "as is" basis at \$168,640
15 and appraised on an "as built" basis at \$510,000, the resulting in loan to value ratios were 157% and 52%
16 respectively.

17 Preferred failed to correct prior deficiencies

18 9. The Staff completed a prior examination of Preferred in 1998 ("1998 Exam"). Following the 1998 Exam
19 the Staff advised Preferred that it was not in compliance with several areas of the Securities Act. During the 2001
20 Exam, the Staff found that Preferred had not corrected the 1998 deficiencies. The 1998 deficiencies included the
21 same issues that are described in paragraphs 5, 7 and 8 above.

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23 Based upon the above Tentative Findings of Fact, the following Conclusions of Law are made:

24 STATEMENT OF CHARGES AND
25 NOTICE OF INTENTION TO SUSPEND
26 AND FINE PREFERRED FUNDING, INC.

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CONCLUSIONS OF LAW

1 1. The offer and sale of mortgage paper securities, described above constitute the offer and sale of a
2 security as defined in RCW 21.20.005(10) and (12).

3 2. The offer and sale of the mortgage paper securities set forth in paragraphs 5 and 9 above is in violation
4 of WAC 460-33A-060 because Preferred failed to record the security interests of investors prior to disbursing
5 funds to borrowers. Such willful failure to comply is grounds for fining Preferred and suspending Preferred's
6 broker-dealer registration pursuant to RCW 21.20.110.

7 3. The offer and sale of the mortgage paper securities set forth in paragraphs 6 and 9 above, is in
8 violation of WAC 460-33A-115(1)(f) because Preferred failed to maintain investor suitability questionnaires in
9 loan files. Such willful failure to comply is grounds for fining Preferred and suspending Preferred's broker-dealer
10 registration pursuant to RCW 21.20.110.

11 4. The offer and sale of the mortgage paper securities set forth in paragraphs 7 and 9 above, is in
12 violation of WAC 460-33A-035 because Preferred failed to obtain written permission of the administrator prior to
13 offering and selling construction loans. Such willful failure to comply is grounds for fining Preferred and
14 suspending Preferred's broker-dealer registration pursuant to RCW 21.20.110.

15 5. The offer and sale of the mortgage paper securities set forth in paragraphs 8 and 9 above, is in
16 violation of WAC 460-33A-035(1) because Preferred offered and sold construction loans having a loan to value
17 ratio based on future improvements and that exceed the 50% limit for unimproved property, as set forth in WAC
18 460-33A-035(7). Such willful failure to comply is grounds for fining Preferred and suspending Preferred's broker-
19 dealer registration pursuant to RCW 21.20.110.

20 **NOTICE OF INTENTION TO FINE AND SUSPEND PREFERRED**

21 Based upon the above Tentative Findings of Fact and Conclusions of Law, the Securities Administrator
22 intends to order that Preferred be fined \$30,000 and be suspended for six (6) months from the date of any final
23 order based on this action.

AUTHORITY AND PROCEDURE

This STATEMENT OF CHARGES AND NOTICE OF INTENTION TO FINE AND SUSPEND PREFERRED is entered pursuant to the provisions of RCW 21.20.110 and is subject to the provisions of RCW 21.20.120 and is subject to the provisions of ch. 34.05 RCW. The respondent, Preferred Funding, Inc. may make a written request for a hearing as set forth in the NOTICE OF OPPORTUNITY TO DEFEND AND OPPORTUNITY FOR HEARING accompanying this order. If Preferred Funding, Inc. does not request a hearing in this matter, the Securities Administrator will, based on the foregoing Findings of Fact and Conclusions of Law, enter an order against Preferred Funding, Inc., imposing a fine of \$30,000 and suspending Preferred's mortgage-broker permit and broker-dealer license for six (6) months from the date of the final order.

DATED AND ENTERED this ____ day of July 2001.

/s/ _____
Deborah R. Bortner
Securities Administrator

Presented by:

Approved by:

/s/ _____
Kristina L. Kneip
Senior Securities Examiner

/s/ _____
Michael E. Stevenson
Chief of Compliance